

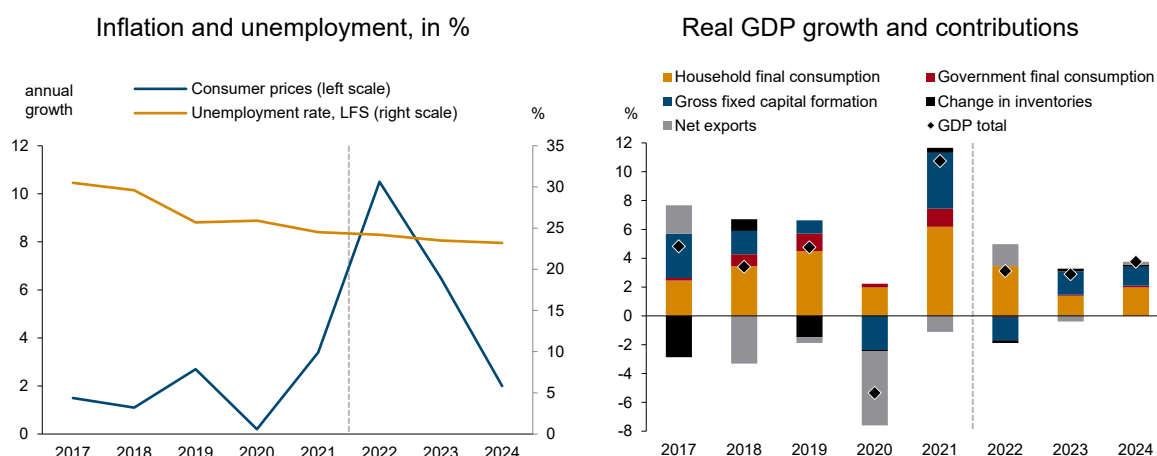


## KOSOVO: Headwinds from soaring inflation and the energy crunch

ISILDA MARA

The economy will grow by around 3% in 2022 and 2023, despite the war-related inflationary pressures and the energy crunch. Inflation is expected to soar to 10% this year, a casualty of rising food and energy prices. The country's trade deficit has deteriorated further, despite the big rise in exports. The positive trend in foreign direct investment has been maintained. The dire state of the labour market and high unemployment suggests that there will be a weakening in consumption, although support from the Kosovo diaspora has increased.

Figure 6.10 / Kosovo: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

**Economic activity has slowed markedly due to the war-related inflationary pressures.** After a strong rebound of 10.5% in 2021, economic growth lost steam in the first half of the year, when it hovered at 3.3%. Household consumption stayed strong for Q1, but when Russia invaded Ukraine the resulting strong inflationary pressure curbed both household and government consumption quite swiftly. Still, it was investment that suffered the most, falling 8% in the first half year. Since the pandemic crisis began, Kosovo has more than doubled its goods exports, and the trend continued this year, too. However, this has not prevented the trade balance from deteriorating further, as imports have grown even faster. In production terms, growth has been supported by the expansion of financial activities and by wholesale and retail trade. Industrial activity, especially manufacturing, has also expanded, although more slowly than last year. The energy crisis has been a drag on economic activity.

**Inflation is expected to hit 10% this year, driven by food and energy prices.** Consumer price inflation in Kosovo jumped to 13% in August and averaged 11.2% for January-August. Over the same period, the cost of transport, food and fuel increased by 19%, 15% and 12%, respectively. That said, from August, inflation has been decelerating, but the lasting effects of the war and the inflationary pressure stemming from the energy crisis suggest that inflation will remain high – at 10% this year and 6.5% next.

**The energy crunch will continue to act as a drag on the economy.** Kosovo is not self-sufficient in energy, and is dependent on imports for close to a third of its requirements (including solid fossil fuels, oil and petroleum, natural gas and renewables). As for electricity, the country seesaws between being a net exporter and a net importer. This year, however, up until July it was a net importer of electricity – and at very high prices. In August, the intolerable electricity prices on the international market forced the Kosovo government to reintroduce a state of emergency and impose energy rationing: power cuts of two hours a day, with the possibility that this state of affairs could continue for six months. This will certainly have repercussions for businesses, production and export-oriented firms.

**The domestic supply of energy and electricity remains dire, as power sources have not been diversified.** Power generation plants are predominantly fired by lignite. Renewable energy production contributes a mere 7% of domestic production. However, the government is seeking to double renewable energy production by 2025, and several hydropower, wind and solar farm projects are in the pipeline.

**The country's trade deficit has deteriorated further, despite the robust rise in exports.** Since the pandemic crisis started, exports have risen steadily, and in 2021 were more than double the pre-pandemic level. Also, in the first half of this year, goods exports surged by roughly 30%. In particular, year-on-year exports of minerals more than doubled in the period to July, thanks to a steep rise in international prices. Nevertheless, this has not been enough to prevent the current account deficit from deteriorating further on account of the high growth in imports. Moreover, because of the trade supply disruptions at the international level, Kosovo has further strengthened trade relations with its neighbours – especially North Macedonia and Serbia – with both exports and imports increasing this year.

**The support of the Kosovo diaspora has grown further.** The diaspora has proved an important source of financing through remittances, foreign direct investment (FDI) and trade. Last year, remittances reached EUR 1.2bn – 15% of GDP. This year, remittances continued to rise – by at least 2% in the first half year. That said, the expectation is that, as the economies of the EU countries – where most Kosovan emigrants reside – head into recession, they will find it harder to save money, so remittances might decline.

**Foreign direct investment has kept growing.** This has been rising steadily – up 40% in the first half of 2022, year on year – and is expected to reach 5% of GDP this year. FDI has continued to be concentrated in real estate. That said, this year the mining and quarrying sector absorbed almost a tenth of FDI, reflecting rising market prices in this sector.

**Demand for credit has expanded rapidly, but the pace is expected to slow as monetary policy tightens.** Credit to households and non-financial private corporations rose by 18% from January to July 2022. Companies – which account for two thirds of the credit – have needed it mainly for inventories and fixed investments. Meanwhile, household credit has gone largely on consumer credit rather than housing loans. The surge in inflation is curbing household spending. The level of non-performing loans is still low

(3%), but is expected to rise as the inflationary pressures persist. In September 2022, the commercial banks increased the loan interest rates to 6.1%, up from 5.6% in January, and this move is expected to rein in demand for credit.

**The dire state of the labour market and high unemployment presage a weakening of consumption.**

Nominal wages have not grown at the same pace as inflation. The available short-term statistics indicate that employment has been rising in manufacturing and other production activities. Employment in the services sector as a whole has also been rising, but has fallen in retail trade. Kosovo has one of the highest unemployment rates in the region, especially among the youth: a third of those aged 15-24 are reported as being unemployed. At 18%, the poverty rate is also among the highest in the region. Remittances remain the main financial source for struggling families. Strikes are an ongoing feature among teachers and other professional groups that are seeking higher wages to cope with the soaring prices.

**More support has been made available to help private companies and the most vulnerable groups cope with the steep rise in prices.**

In September 2022, the government extended its April Recovery Package at a cost to the budget of EUR 150m (2% of GDP). Pensioners will receive an additional one-off cash payment of EUR 100; public employees will receive a one-off EUR 50; private businesses will have wage rises subsidised up to EUR 100 a month for three months; while students will also get a lump sum of EUR 100 to cope with the steep rise in prices. Other measures have been introduced, such as a price cap on fuel and subsidies on electricity, especially for low earners. This will certainly place the general government budget under strain, despite the fiscal surplus recorded in the year up to July. Because of the energy crunch and the inflationary pressures, public capital expenditure contracted by almost 38% in the year to July, claiming a very small share of total budget expenditure (6%).

**In a nutshell, we expect the economy to grow by 3.1% this year.** We have revised our forecast for inflation slightly upwards (from 8.5% to 10%) and for GDP slightly downwards (from 3.3% to 3.1%) owing to the energy and inflationary pressures. With the approach of winter, these pressures are expected increasingly to be felt – and particularly in 2023. Accordingly, we have revised our forecast for growth in 2023 slightly downwards, to 2.9%.

**Table 6.10 / Kosovo: Selected economic indicators**

	2019	2020	2021 <sup>1)</sup>	2021 January-June	2022	2022 Forecast	2023 Forecast	2024
Population, th pers., average	1,789	1,790	1,786	.	.	1,798	1,800	1,802
Gross domestic product, EUR m, nom.	7,056	6,772	7,958	3,554	3,911	9,100	10,000	10,600
annual change in % (real)	4.8	-5.3	10.7	10.8	3.2	3.1	2.9	3.8
GDP/capita (EUR at PPP)	8020	7550	8970	.	.	.	.	.
Consumption of households, EUR m, nom.	5,621	5,718	6,572	3,088	3,604	.	.	.
annual change in % (real)	5.7	2.5	7.3	8.7	6.7	4.2	1.7	2.4
Gross fixed capital form., EUR m, nom.	2,190	2,012	2,617	.	.	.	.	.
annual change in % (real)	2.9	-7.6	13.0	.	.	-5.0	5.0	4.0
Gross industrial production <sup>2)</sup>								
annual change in % (real)	6.3	0.8	21.7	32.2	0.3	4.5	4.0	4.0
Gross agricultural production								
annual change in % (real)	9.5	2.7	4.0	.	.	.	.	.
Construction output <sup>3)</sup>								
annual change in % (real)	1.5	-9.0	8.8	.	.	.	.	.
Employed persons, LFS, th, average <sup>4)</sup>	363.2	347.1	375.0	.	.	378	380	385
annual change in %	5.2	-4.4	8.0	.	.	0.8	0.5	1.0
Unemployed persons, LFS, th, average <sup>4)</sup>	125.3	121.4	120.0	.	.	120	120	120
Unemployment rate, LFS, in %, average <sup>4)</sup>	25.7	25.9	24.5	.	.	24.2	23.5	23.2
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.
Average monthly gross wages, EUR	477	466	484	.	.	560	620	660
annual change in % (real, gross)	2.5	-2.5	0.4	.	.	5.0	4.0	4.0
Average monthly net wages, EUR	430	416	432	554.2	493.5	500	540	560
annual change in % (real, net)	2.4	-3.4	0.4	0.5	-19.4	4.0	2.0	2.0
Consumer prices (HICP), % p.a.	2.7	0.2	3.4	10.4	10.4	10.5	6.5	2.0
Producer prices, % p.a.	0.9	-0.6	4.9	2.8	9.8	10.0	6.5	3.0
General governm. budget, nat. def., % of GDP								
Revenues	26.8	25.4	27.4	27.6	28.9	28.0	28.5	28.8
Expenditures	29.7	33.0	28.8	27.7	24.9	27.0	28.0	28.5
Deficit (-) / surplus (+)	-2.9	-7.6	-1.3	0.0	4.0	1.0	0.5	0.3
General gov. gross debt, nat. def., % of GDP	17.0	22.0	21.1	23.2	20.8	20.0	19.0	18.0
Stock of loans of non-fin. private sector, % p.a.	10.0	7.1	15.4			.	.	.
Non-performing loans (NPL), in %, eop	2.0	2.7	2.3	2.5	2.1	.	.	.
Central bank policy rate, % p.a., eop <sup>5)</sup>	6.42	6.01	5.80	6.0	6.0	6.0	6.0	6.0
Current account, EUR m	-399	-472	-695	-468	-627	-810	-780	-750
Current account, % of GDP	-5.7	-7.0	-8.7	-13.2	-16.0	-8.9	-7.8	-7.1
Exports of goods, BOP, EUR m	393	475	753	344	451	880	970	1,060
annual change in %	4.4	20.8	58.4	61.6	31.1	17.0	10.0	9.0
Imports of goods, BOP, EUR m	3,233	3,048	4,320	1,912	2,425	4,790	4,980	5,180
annual change in %	3.8	-5.7	41.7	41.4	26.8	11.0	4.0	4.0
Exports of services, BOP, EUR m	1,675	995	1,906	575	875	2,130	2,260	2,350
annual change in %	7.3	-40.6	91.6	44.8	52.1	12.0	6.0	4.0
Imports of services, BOP, EUR m	749	603	871	337	466	980	1,080	1,130
annual change in %	6.1	-19.5	44.4	36.3	38.3	12.0	10.0	4.5
FDI liabilities, EUR mn	255	346	421	225	327	460	.	.
FDI assets, EUR mn	66	59	100	45	82	20	.	.
Gross reserves of CB excl. gold, EUR m	864	901	1,100	947	1,280	.	.	.
Gross external debt, EUR m	2,201	2,517	2,976	2,692	3,192	3,200	3,200	3,200
Gross external debt, % of GDP	31.2	37.2	37.4	33.8	35.1	35.0	32.0	30.0

1) Preliminary. - 2) Turnover in manufacturing industry (NACE C). - 3) Based on gross value added data. - 4) Population 15-64. - 5) Average weighted effective lending interest rate of commercial banks (Kosovo uses the euro as national currency).

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.